DOW THEORY LETTERS INC.

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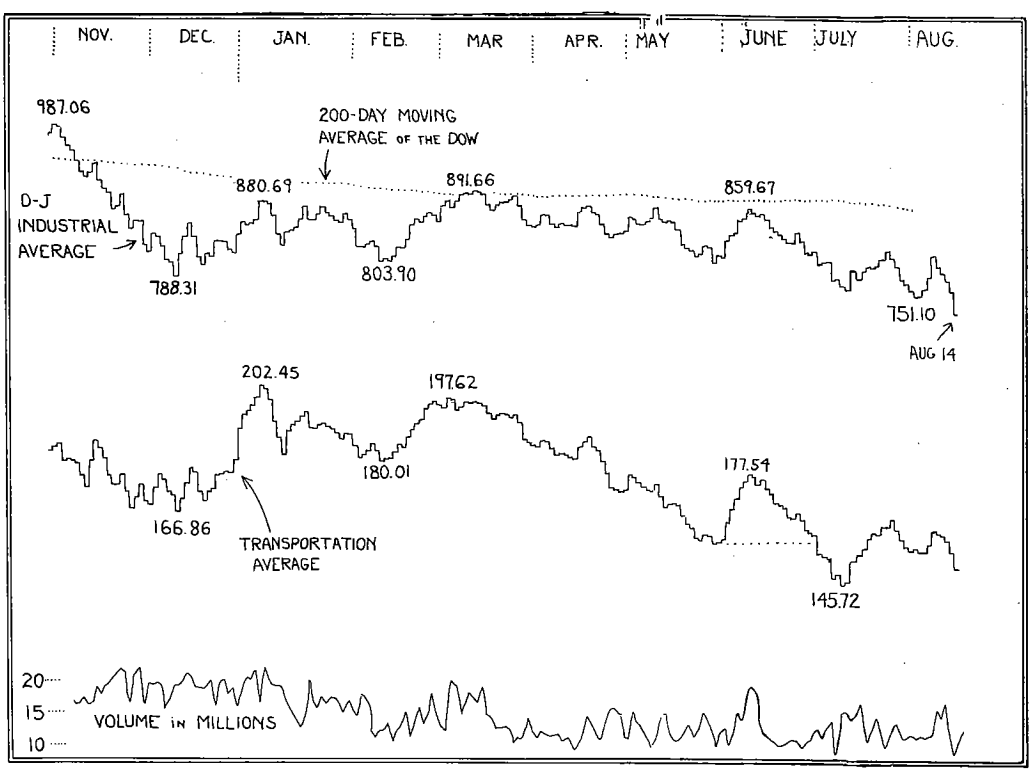
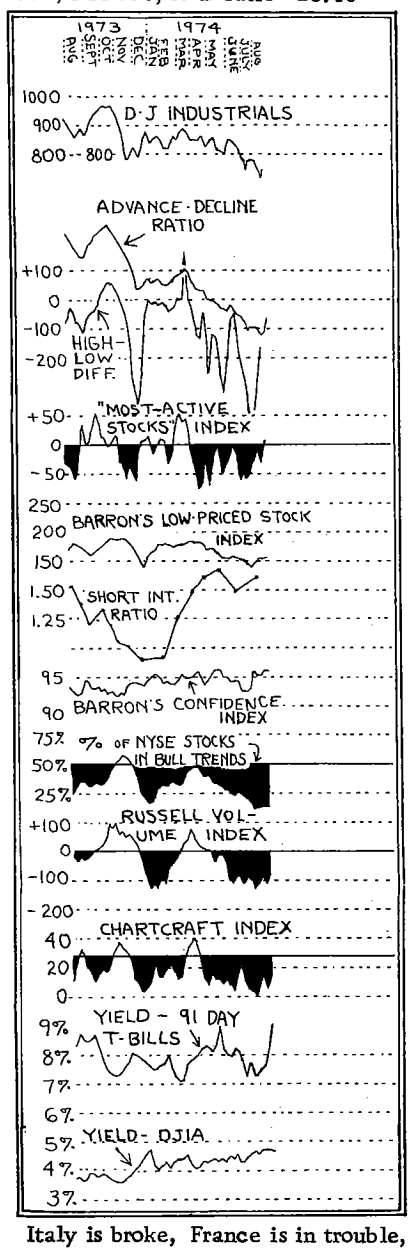
Aug. 2, DJIA 752.58; PTI 328; A-D ratio -29.12
Aug. 9, DJIA 777.30; PTI 338; A-D ratio -28.16

ANOTHER WEEK THAT WAS: Last week the US wholesale price index (annualized) jumped up at a record rate of 44%. Last week the D-J Commodity Futures Index bounced to a new high. Last week investors gobbled up $2.25 billion of 33 month notes issued by the US Government. The notes carried a record yield of 9%. Last week for the first time I heard a radio commercial by the National Bank of Mexico asking for Yankee dollar deposits (I'm located about 25 miles north of the Mexican border, and we pick up most of the border Mexican stations here). Even our neighbors to the South are joining the scramble. Last week saw new lows in the Japanese yen and a five month low in (believe it or not) the German mark. I knew Japan was in severe trouble but what's happening in Germany? Last week President Nixon (who came in at Dow 931.25, resigned with the Dow (August 8) at 784.89. His successor, Gerald Ford, is inheriting a primary bear market. He'll probably see the Dow a good deal lower before his first term is over. General Motors last week announced a $500 boost in 1975 cars (I'm not saying GM doesn't need it, I'm just saying that I don't think they're going to sell 'em). Last week Southern California carpenters got wage boosts giving them $108 a day. I don't think builders here are going to sell houses either.

THE PICTURE: Gerald Ford is our new President, and I believe he means well, and I believe he's honest. That's at least a healthy step in the right direction. But changing Presidents, unfortunately, will not change the primary trend of the market or the economy any more than changing the sand on the beach will reverse the tide of the ocean.

The problems facing the US and the world today are simply tremendous, and so far they have not been solved (I hope that they will now at least be dealt with). For instance, within a few years the Arabs are going to have most of the world's money. That process will entail the running up of astronomical debts on the part of the oil-using nations. Already





Italy is broke, France is in trouble, Britain is bankrupt, Belgium is in severe straits, Denmark is near-broke, Japan is perilously close to the edge, Israel is insolvent. The Arabs are accumulating all kinds of monetary paper and credits and work-trade agreements and know-how-for-oil agreements, but there isn't enough Western know-how and work to balance the massive amount of paper IOU's the Arabs are piling up.

How long will the Arabs be satisfied with the current monetary non-agreements? How long will they

continue to trust paper dollars? The Arabs are worried stiff about losses (via inflation or insolvencies or both), and they will ultimately demand guarantees which will stand up under any emergencies. I give the whole Arab situation less than a year. When the Arabs see that they have been "taken" they will call a halt. Then the crisis will begin — in earnest.

I've been stressing one theme in Letter after Letter, and I'll now underscore it again. We're moving into (or we're already in) the greatest liquidity scramble in recorded history. The banks are out of money, the Government is out of money, the cities and the corporations are out of money. Joe citizen has a little money left, and it's the only liquidity around. This is the stuff everybody is zeroing in on now, and the battle lines are being drawn. US Government 9's, floating bank notes; they're the beginning. In July savings banks lost three-quarters of a billion dollars in deposits; August will probably show a loss of double that figure. Watch the coming battle for greenbacks. It's going to be awe-inspiring, and it's going to boil down to this: super-inflation or collapse or maybe both. The question is, can super-inflation create enough "money" to ward off an economic cave-in? Personally, I doubt it, but the question should be answered soon enough.

Mutual savings banks had a net deposit outflow of $725 million.

The July outflow was the largest for any month since the industry began compiling monthly statistics in 1947, the National Assn. of Mutual Savings Banks reported. The previous heaviest deposit outflow was $651 million in August, 1973. At the end of July, deposits in mutual savings banks totaled an estimated $97.6 billion, up $2.2 billion from a year ago, the association said.

I ask myself what happens when today's "uneasiness" turns into a full-blown recession (which it will probably be next year), and the Government finds that its tax take is off by perhaps $25 to $50 billion? Does poor Gerald Ford (I think I feel sorry for him already) have the answer to that one? What happens if the Government continues to come into the note market while paying record-high interest rates, sopping up billions of dollars from the "little guy" and cleaning out the banks and savings & loan associations? Is this clip from the August 7 New York Times a peak at the future, is it a preview of "the money panic of the 1970's"? In my opinion, a gathering recession and a coming profits collapse is going to turn 1975 into the first year of hyper (monetary) inflation, a year in which the US Government, Mr. Ford and the Fed do a complete flip-flop and start the presses and the make-work programs rolling. In which case, watch the gold stocks.

Investors Queue Up To Buy U.S. Notes With Peak 9% Rate

By JOHN H. ALLAN

Thousands of investors, most of them disgruntled with interest rates on their savings accounts and not interested in the stock market, flocked yesterday to buy the Federal Government's new 9 per cent notes —the highest rate ever put on a Treasury issue maturing in more than a year.

Demand for the notes was so great that the actual yield investors will get on the notes will be somewhat less than 9 per cent. Even so, the return will be a large increase from the 5¼ per cent that many, if not most, of the purchasers were getting on their money before withdrawing it from savings accounts.

An estimated 5,000 to 6,000 individuals waited patiently in the sunshine outside the Federal Reserve Bank of New

In the latest (August) issue of the authoritative Bank Credit Analyst (1245 Sherbrooke St., West, Montreal 109, Canada), Editor Boeckh talking about "the world recession which is almost certainly going to take place" and the implications of such an event (which Boeckh believes will start in 1975), notes that "What we do know is that we are on track for a major financial crisis and possible panic. Unless something good happens to avert it, we could well go over the top this time around."

I believe that a recession next year would send us "over the top." Corporate liquidity is now low in the extreme, banks are in tenuous shape (particularly the smaller ones), the Fed is continuing to follow a tough money policy which is forcing the Government to take on all comers via record interest (debt) issues, the Eurodollar market is wobbly, the citizens of the world are becoming distrustful of the banks (and as C.V. Myers puts it, why should people trust the banks when the banks no longer trust each other?).

Put it all together, and I come up with my basic law of primary bear market. During a bear market, anything can be jarred loose, anything that can be toppled, anything that can undermine the economy, anything that can shatter confidence — will materialize in due time. That, unfortunately is how bear markets work. You can count on it, and what worries me is that so much that will be covered by this "law" is fated to surface in the period ahead.

THE MARKET: Subscribers sometimes wonder why I don't turn bullish when the market suddenly rallies from a deeply oversold condition (as it just did) or when puzzling or frustrating events seem to be on their way to being resolved (such as the Nixon affair). The reason I don't become bullish is that I know that bear markets (and we are in one) are out to break the investor and destroy the speculator. Now how are you going to continue to pulverize stockholders and others if you have a bear market that is over in six months or so? How are you going to separate the hopefuls from their money if you "advertise" the bear market bottom with good news, a big selling climax, then a wild rally (actually, true bear market bottoms come on dull, listless volume, not on dramatic selling climaxes)? And how are you going to take Joe America to the cleaners if you have fifty investment services shouting that "It's now so bad, the worst must be over?" Look at the 1942 or 1949 issues of Barron's at your public library. There literally weren't any investment services to do the shouting at those actual primary bear market bottoms!

"Russell," the little voice asks, "what do you want, blood? How bad does it have to get before you turn bullish? What are you going to do, self-destruct at the final bottom just to make it look bad?" And sheepishly I will say as I have been saying ever since this bear market began, "No; I am not going to do anything but continue to call the shots as I see them. I don't make the market, I don't affect the trend one iota. I only tell the story as my charts and my intuition and my cerebrum feed it to me. And if the story doesn't dovetail with what I would like or what my subscribers want, well, all I can say is 'Relax, have a martini, go out and watch the ocean or the sky or the snow or whatever your part of the country offers. This bear market (like all others) will pass, but in its own good time, not when we want it to'."

Referring to the page 1 chart, we note that the big August rally has (so far) lasted four trading days. It succeeded in taking the Dow from the August 11 low of 751.10 to an August high (four days later) of 797.56. All of which reminds me of the current song, "Is That All There Is?" I don't know if that's all there is, but it is worth noting that most "decent" upward corrective movements take the form of a "twin-pronged attack," a first wave and then a second which surpasses the first. We've only had "one prong" so far. If August 11 represented the end of the 1974 summer rally then I would say that we are in for a very, very dismal Fall (see Will-Go study in this Letter). As they say, "if the market won't go up, then it sure as hell will go down."

The August rally in the Dow failed to recoup half the losses of the last decline (i.e., the decline from the June 10 peak of 859.67 to the August low of 751.10). That's not a good sign, but we could, of course, still get another try on the upside. The A-D ratio acted sluggishly during the early August rally, while on the decline (which started Aug. 8) the A-D lost almost all its rally gains (hardly a bullish indication). On August 13 the Primary Trend Index (PTI) actually broke to a new bear market low, a depressing sign for those who insist that "the bottom is just around the corner."

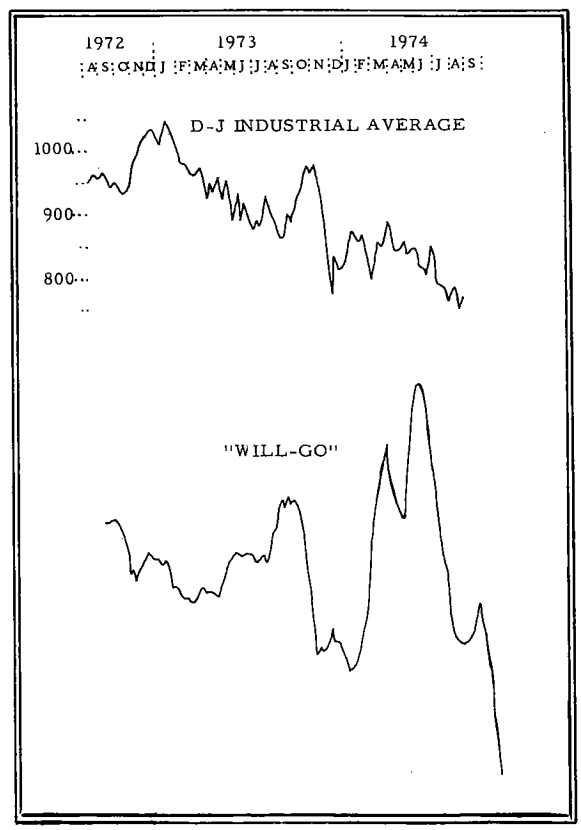
It's really too early to write off the possibility of further rally, but my guess remains that (1) the August action will be the best we will see for a while, and (2) the Fall will not be a happy one for Wall Street.

Last week the British market smashed to another 15-year low. I consider this to be a bearish omen for our market. I am afraid that most of today's investors and most of my colleagues in this business (with a very few notable exceptions) are thinking in terms of what has happened since World War II. I hate to say it but the War is over, the boom is over, the great 1949-66 bull market is over, the great era of "beat next year" is over. Change is here. And readers, I mean CHANGE.

"WILL-GO": Maybe I should call this Letter the yield report or the bond special, but bonds and yields are "where it's at" at this juncture, and we might as well study this picture carefully (after all, the bond market dwarfs the stock market in terms of money involved, and there is alot of frightened money around today).

Letter 604 seems to have stirred up a great deal of interest in Will-Go, the yield-oriented index which possesses a good record for predicting forthcoming movements in the Dow. Will-Go is particularly interesting at this juncture, since we now have record lows in bond prices (with, of course, rising bond yields) and an August rally in the stock market (with accompanying lower yields on the Dow Industrials). Will-Go is a function of the differential in the yields of Barron's 10 High-Grade Bonds and the yield on the Dow Industrial Average. This figure can be found each week on the Market Laboratory page of Barron's.

Currently, there is approximately a 4.5% differential (spread) in the yield on the Dow and the yield on the Bonds in favor of the Bonds. This constitutes a negative spread, but it is the trend of the spread which moves Will-Go. The larger the negative spread (regardless of whether the negative spread is caused by falling bond prices or rallying stock prices), the more bearish the readings for Will-Go. Conversely, as the yield differential decreases in the direction of a positive yield spread (in favor of stocks), Will-Go's readings become progressively more bullish.



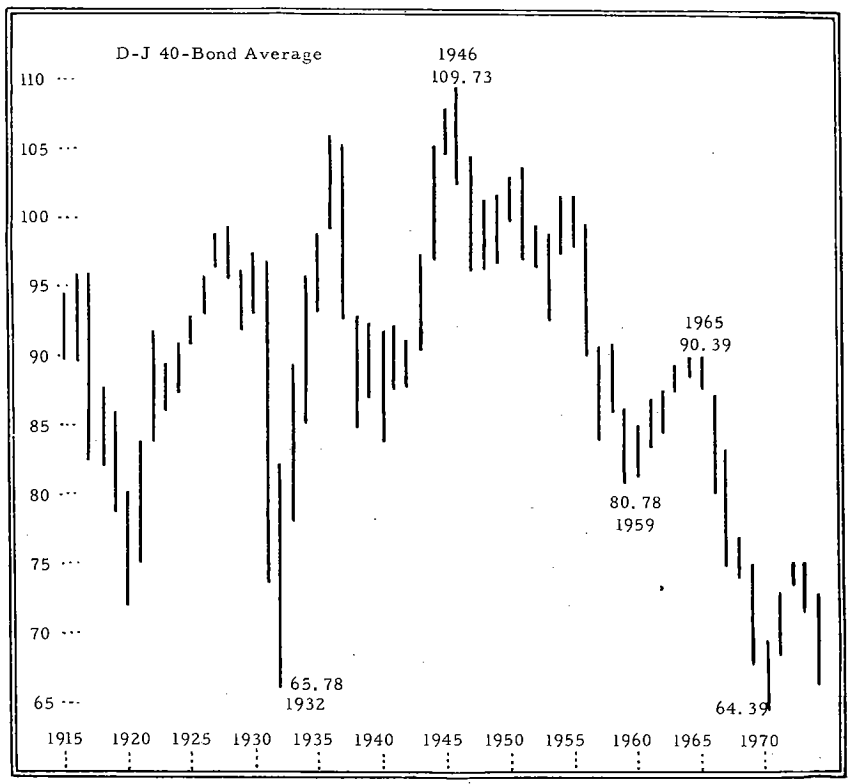
Will-Go is actually constructed as follows. The Barron's yield spreads (between DJIA yield and Hi-Grade Bond yield) are entered each week. The differential between the latest reading and the reading five weeks ago is added (or subtracted) to a running total. This total is then plotted (as I have done on the accompanying chart) with a lead time of 10 weeks (Will-Go is plotted 10 weeks ahead of the Dow).

Larry Williams (who invented Will-Go) named it that because he said that wherever this indicator goes, the market "will go." Nevertheless, in working with Will-Go the following should be kept in mind: (1) Will-Go, like all technical devices, is not infallible. (2) The lead time in Will-Go runs around 10 weeks, but it can vary. (3) Will-Go deals mainly with the forthcoming direction of movement in the Dow, not with extent of movement.

I am writing this piece about Will-Go because Will-Go now seems to be flashing its little interest-sensitive crystal ball — loud and clear. Will-Go is predicting a less-than-spectacular rally for August, then a most definite decline starting around the end of August or in early September. Will-Go, starting from the early September peak (see chart) has been plunging for six consecutive weeks. It seems to be saying that Fall, 1974, will be a very bad time for Wall Street and the stock market.

 The August rally in the stock market and the continuing decline in the bond market has thrown Will-Go very heavily into the bear camp. The latest bond-stock yield differential was 4.64 (see Barron's, August 12) the greatest spread in favor of bond yields on record! The fact is that Will-Go is emphasizing what I have said all along in this primary bear market, "You can't have a bull market in stocks occurring within the framework of a collapsing bond market. You just can't build a skyscraper on a foundation of mud."

BONDS: The US is a "credit society." This means that the structure of the entire US financial system is built on a base of capital (or cash) and credit (or debt). The capital part of the structure is the visible one. The capital is the cash in the bank, your bank account, your net worth (car, house, furniture, stocks, paintings, stamps, coins, etc.). But the credit side of the ledger is not as obvious, and to the average citizen it is a vague mystery. What you owe, what your company owes, what your city, municipality, state owes, what the Government owes, the bonds, the notes, the bills, the C/D's, etc., all this constitutes the debt of the nation.



No one knows exactly what the entire debt in the US amounts to. Conservatively, it has been put above two trillion dollars. The figures are so astronomical that it almost doesn't matter any more. What does matter is whether the debt is still servicable or whether it is eating the nation up alive. I don't want to put forth a mixed bag of economic theories and formulas on debt formation, sustainability, danger levels, and so forth.

What I am interested in is the trend, the movement, the forces which affect the debt. One of the instruments I use to watch debt is the action of the D-J 40-Bond Average. I don't just use a daily chart (I keep one, of course), and I don't just use a monthly chart. If you really want to see the sweep of history you have to put things in historical perspective. For this I use the accompanying annual (yearly high-low range) chart of the broad 40-Bond Average, a chart going back to 1914.

Most people do not realize it, but bonds move within major primary bull and bear markets as do common stocks. However, the primary trends in bonds appear to take much longer than stocks; they are also less subject to short-term or temporary influences. I interpret the long-term bond chart as showing a bear market in bonds from 1917 to 1920. A bull market ran from 1920 to 1928. From 1928 to 1932 a bear market held sway. From the 1932 low of 65.78, a great bull market in bonds carried all through the Great Depression of the 1930's and through World War II and up to 1946. From that point on, massive debt accumulation and rising inflation took over, and a bear market in bonds was on.

The 1946 bull market high for the 40-Bonds was 109.73. By 1959 the bear market had taken the bonds down 26% to 80.78. By 1970 the 40-Bond Average had declined to 64.36, down 41% and actually below the 1932 Depression low. A rally (correction) took the 40-Bonds up to the 75 area during 1972-73. By last week the Bonds had sunk to 65.90 little more than a point above the 64.36 low of 1970 (and remember that the 1970 low represented the lowest level ever seen on the D-J 40-Bond Average).

As veteran subscribers know, I hold that (1) a declining trend in bonds always represents a negative background for stocks. (2) A declining trend in both bonds and utilities represents a doubly negative background for stocks. (3) Past experience suggests that the D-J 40-Bond Average will hit bottom before the D-J Industrial Average.

The trend of the 40-Bond Average has been down throughout 1974. The 40-Bonds hit a four year low on August 7 at 65.90 This low occurred four trading days after the 1974 Dow Industrial low of 751.10. This series alone suggests that the Dow will go lower in due time.

A few historical notes may be in order here. During the great 1929-32 bear market, the D-J 40-Bond Average hit its low of 65.78 on June 1, 1932. This was one month ahead of the final bear market low for the DJIA. In the primary bear market of 1937-42 the 40-Bond Average recorded its low of 83.06 in May, 1940. This was two years before the final 1942 low for the Dow. In the primary bear market of 1946-49, the 40-Bonds recorded their low of 96.54 in December, 1947. This was eighteen months ahead of the final low for the Dow (which occurred in June, 1949).

Finally, this clip from the August 12 Wall Street Journal, regarding Southern Co., a major utility company. Maybe this clip tells us the whole, incredible story.

Southern Co. Unit Is Cleared to Issue Notes at Up to 14.5%

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Georgia Power Needed SEC Approval for $250 Million In Short-Term Borrowing

By a WALL STREET JOURNAL *Staff Reporter*

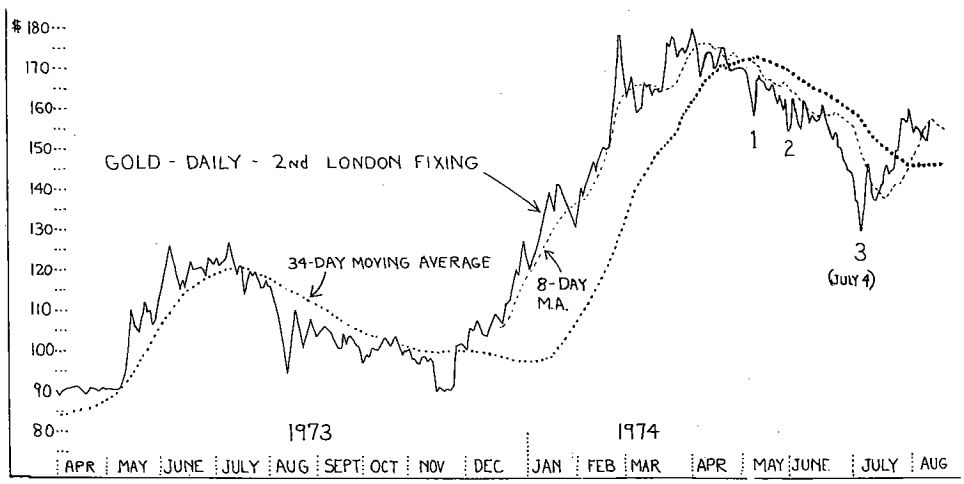
WASHINGTON—The Securities and Exchange Commission authorized Georgia Power Co., a unit of Southern Co., to issue up to $250 million in short-term notes at interest rates ranging up to 20% above the prime, or basic, lending rate. That would mean an astounding indicated annual interest cost of up to about 14.5%.

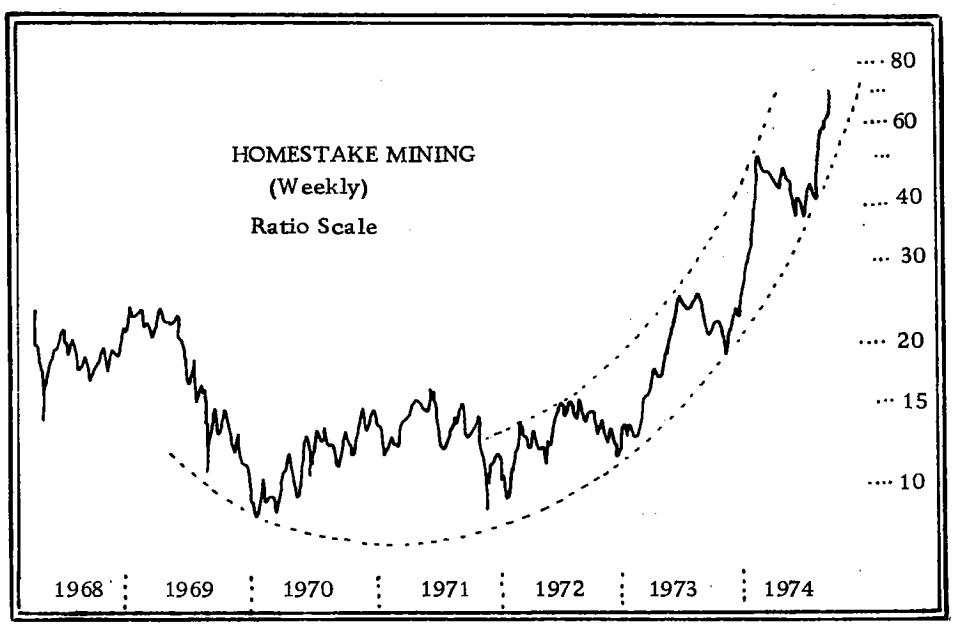
GOLD, GOLD SHARES: Not one in a thousand investors believes in or understands the meaning of the great primary bull market in gold. Nations denounce it, the US Treasury ridicules it, politicians warn against it, investment advisors ignore it or laugh it off. And all the while the tidal forces underlying the gold move build, ripple, strain like a bound Herculean giant which is about to smash his chains and rise to his full height and strength.

My daily gold chart shows gold moving up nicely from its $129 correction low of July 4. On July 29 the 8-day moving average (MA) of gold rose above the 34-day MA, rendering a bullish signal. With the 8-day now holding above the 34-day, the latter is turning up, another bullish indication. A third bullish sign is that at the July peak of $159, gold had recovered more than half of the $30 loss suffered during the March-July correction. Prognosis: gold will, in due time, test and then better its old bull market high.

As suggested in many Letters this year, Homestake is now becoming the best-acting stock on the NYSE. For seven years I have been pushing subscribers to buy HM. I was told that it was too "risky," that the US would confiscate the mine, that it couldn't produce enough, that it didn't have all its assets in gold, on and on. The US will not confiscate the Homestake, the Administration will probably give it a blue ribbon before this monetary mess is over. HM has the ore reserves, the know-how, the expert management, the money. It's a top investment, and the big money now pouring into HM speaks louder than all the empty words.

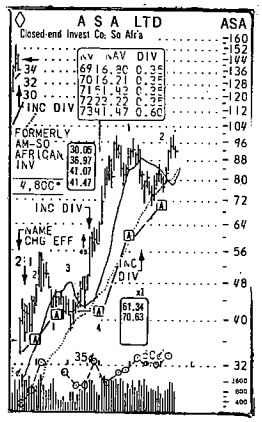
I have drawn the accompanying semi-log chart covering 7 years of weekly HM action. I take the whole period of 1969 to 1973 as one gigantic base for HM, a base which is now propelling the biggest gold mine this side of S. Africa into the all-time high list day after day. I have drawn a channel on the chart based on a Phillips curve. The curve is exponential, meaning that it will move in time toward the vertical. I don't know where HM is heading or where it will be in the next year or so. I hate to use "projections," but my point & figure charts indicate that the 1969-73 HM base could support a price of over $200 on the current shares. Stock Market Alert (189 De La Warr Rd., Bexhill-on-Sea, Sussex TN40 2JY, England) does a superb computerized job on stocks and earnings. In their latest report they say, "If the current rate of growth on a moving annual basis of 121.9% is maintained throughout the remainder of the current fiscal year, then HM will report earnings of above $4.40 per share by December. Revenues for the quarter to June at $37.3 million vs. $26.5 million were a record for any quarter in HM's history and were up 40.8%." Nuff said.





At any rate, I presented a study of the gold group in the last report, and I opined that golds were beginning to move into the third (psychological) phase of their great bull market. I feel that HM and ASA are leading the way for the rest of the golds. ASA and HM are the two "showcase" gold stocks, and they

are now getting the big buying, the informed buying, probably some institutional buying. Dome and Campbell Red Lake come second.

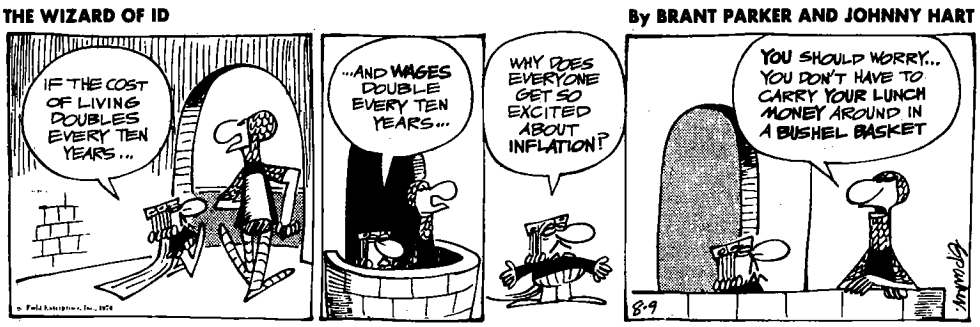


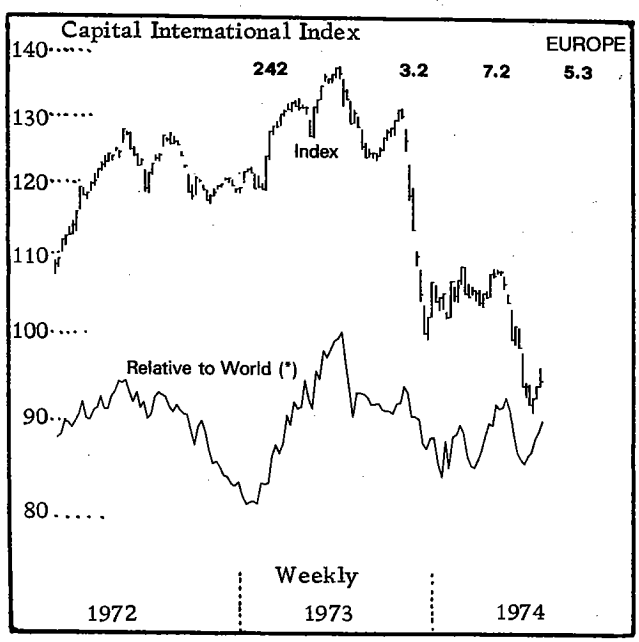
On August 14 (as this is written) ASA broke above the 100 resistance line and rose to a new all-time high. This stock has traditionally been a $25-35 number, and it would not surprise me if we have a two or three for one split in ASA sometime this year or early next. As seen on this chart (courtesy of Quote, PO Box 213, Wichita, KS 67201), ASA has been building a beautiful base during 1974, and the breakout above 100 should prove valid and a spur to the rest of the S. African issues.

Many late-comers to the gold scene get "nudgy" when they buy their stocks and after a few months they find that they are "just even" or even a little behind. This is OK. It's bad luck to make money too fast, and I don't think I've ever bought a stock that didn't show me a paper loss within a few weeks. But if you're right on the primary trend, if you're riding a primary bull market (such as the current bull market in golds), then the tide will carry your combined assets to successive new highs until the ultimate bull market top. Right now, I would bet that most diversified gold portfolios are near the highest levels since you started accumulating. If not, then just give the bull market more time, and the tide will bail you out. People are asking me when this or that gold share will move. Vaal Reefs is lagging, Pamour is too slow, Mozambique has scared investors, Canada has finished off the gold move with high taxes, on and on. And here is what I say. One way or another, this gold market is going to blow its top. The current minuses are going to turn to plusses and the gold market is going to blow. A tottering Portugal hasn't prevented a record high on ASA. Treasury Under-Secretary Volcker (who scared the devil out of goldphiles last year) is now gone and HM has tripled in price. Before this gold bull market is over, almost every individual gold stock will have its turn to "rock out" on the upside, each will have its rumor, its excitement, its day. That's the way bull markets work. Gold stocks to buy here — ASA, Dome, West Driefontein, Vaal Reefs.

LATE NOTES: I wanted to include a section on NYSE margins in this Letter, but no room, so I'll hold it for the next Letter.... Please, I can't give personal advice and I appreciate all letters, reports, news clips immensely but I can't answer all letters.... This report sounds a bit serious so I'm including this comment from the Wizard....

I receive huge numbers of reports here, many of them outstanding and if I had to purchase them they would cost thousands of dollars. Fortunately, these services and publications trade with me on a complimentary basis. I realize that the great majority of my subscribers have a limited budget and limited time, but nevertheless I often say, "Whew, I wish they could see this." One excellent publication is Capital International Perspective, 15, rue du Cendrier, CH 1201 Geneva, Switzerland. This outfit does an extraordinary job on international stocks and markets. I include here their chart of the European composite, an index of the stock averages of 16 European nations. The picture here is of a crash, and the lower line shows the composite relative to the World Average of all nations. This chart is saying that Europe is in severe trouble. Since the 1973 high, the European markets are down by one third!


THE WIZARD OF ID
By BRANT PARKER AND JOHNNY HART
IF THE COST OF LIVING DOUBLES EVERY TEN YEARS...
...AND WAGES DOUBLE EVERY TEN YEARS...
WHY DOES EVERYONE GET SO EXCITED ABOUT INFLATION?
YOU SHOULD WORRY.. YOU DON'T HAVE TO CARRY YOUR LUNCH MONEY AROUND IN A BUSHEL BASKET
8-9



Final thought: Periodically some market tool or approach seems to become fashionable. Over the last year it has been "contrary opinion" and measures of pessimism. When a certain market approach "takes over" Wall Street I become very, very wary of it. My feeling now is that those who follow the "bullish-bearish" ratings approach are going to be smashed by the bear. "Too many shorts, too many advisories bearish, too many investors scared, it's all so bullish." To which I say be careful, I think there are too many people pointing to "too much bearishness." It's not going to work that easily this time.

LATE...Dow down 14 points (before the close, Aug. 14), London smashed down to 219 (down another 10 points today), and Jim Blanchard (head of Amer. Committee to Legalize Gold) just called me from New Orleans to tell me that President Ford signs the gold legalization bill today at 5PM. Quite a day!